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In the Supreme Court of the United States

OCTOBER TERM, 1965

UNITED STATES OF AMERICA, *Petitioner*

vs.

W. H. WARDLAW, *Independent Executor of the Estate of C. W. Wardlaw, Deceased, et al.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The District Court did not file an opinion. Its findings of fact and conclusions of law in **United States v. Wardlaw** (R.3-20) are reported at 223 F.Supp. 631. The opinion of the Court of Appeals (Pet. 23-25) is reported at 344 F.2d 225.

JURISDICTION

The judgment of the Court of Appeals was entered on April 8, 1965. (Pet. 22). The petition for a writ of certiorari was filed on September 3, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

QUESTION PRESENTED

Whether the livestock farmers in the **Wardlaw** case, having had to choose their method of accounting in years prior to 1944, and hence not having been afforded a "meaningful choice" under the rule of **United States v. Ekberg,** 291 F.2d 913, (C.C.A. 8th, 1961), and having been forced by Regulation 111, Sec. 29.22(c)-6 to use the unit-livestock-price method of valuing their inventories, can be compelled by the Commissioner to include their raised breeding animals in inventory, along with their livestock held for sale to customers in the ordinary course of business.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code of 1954
- Section 446(e) (26 U.S.C. Sec. 446)
- Section 1231 (26 USC Sec. 1231)
  (appearing at pp. 37 and 44, Appendix B, Pet.)

Treasury Regulation, Internal Revenue Code of 1954
- Section 1.61-4
- Section 1.162-12
- Section 1.167(a)-6(b)
- Section 1.446-1(e)(2)(i)
- Section 1.471-6
  (appearing at pp. 37 through 44, Appendix B. Pet.)

Treasury Regulation 111, Internal Revenue Code of 1939
- Section 29.22(a)-7
- Section 29.22(c)-6
  (appearing at p. 16, Appendix A. infra)

STATEMENT

The taxpayers in the **Wardlaw** case are ranchers engaged in the business of breeding and raising sheep,

goats and cattle for the production of wool, mohair, mutton and calves. When they commenced business,[1] which was from one to thirty years prior to the enactment in 1942 of Section 117(j) of the Internal Revenue Code of 1939,[2] and the promulgation of Regulation 111, Sec.29.22(c)-6[3], taxpayers adopted the accrual method of accounting and the constant unit price method of valuing their inventories. Section 29.22(c)-6 provided that a livestock raiser who, prior to 1944, had adopted the constant unit price method of valuing his livestock inventories, and who had filed returns on this basis, was considered as having elected the "unit-livestock-price method"; and, in addition, Sec.29.22(c)-6 provided that a taxpayer electing the unit-livestock-price method was required to include in his livestock inventory "all livestock raised, whether for sale or for draft, breeding, or dairy purposes." As a result of being thus compelled by this Section of the Regulations to include their raised breeding animals in inventory, the taxpayers in the **Wardlaw** case were forced to include in their **ordinary income** the initial inventory values of their raised breeding animals and thereafter the annual increases in inventory values assigned to such animals, including the tax years, 1957-1959, inclusive, here involved,[4] despite the fact that

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1—One of the taxpayers commenced his ranching business prior to 1913, one in 1917, three in 1927, one in 1935, and one in 1941 (R. 7).

2—Sub-section (j) was added to Section 117 by the Revenue Act of 1942.

3—As amended by Treasury Decision 5423, 1945 Cum. Bull. 70, effective January 1, 1944, the present counterpart of which is Reg. 1.471-6.

4—This result is admitted by the Government (Stip. 25, R. 75), and the District Court found as a fact that the result of taxpayers being required by the Regulation to use the unit-livestock-price method and include raised breeding animals in inventory was that the initial inventory value of raised breeding animals put in inventory was taxed as ordinary income and all annual increases thereafter in inventory value of such raised breeding animals were also taxed as ordinary income. (Findings of Fact 11, R.11).

Section 117(j) and its successor, Section 1231, plainly provided that gain from the sale of "property used in the trade or business" should be taxed as capital gain, and despite the fact that the taxpayers had no "meaningful choice"[5] when they were required to select their accounting method, and had no choice at all as to whether or not they would use the unit-livestock-price method of valuing their inventories.

The District Court held that the selection of the accrual method of accounting and the unit-livestock price method of valuing inventory, by the taxpayers in the **Wardlaw** case, when they commenced operating their ranches, was not a meaningful choice inasmuch as the statute then did not authorize capital gains treatment on the sale of livestock used for breeding purposes.[6] (R.18). The District Court also held that, under these circumstances, the Regulation requiring the inclusion of raised breeding animals in inventory was invalid as to the livestock farmers before the Court, and that the requirement that raised breeding animals be included in inventory was in conflict with Section 1231 of the Internal Revenue Code. (R.16-17).

The District Court further found that the removal of livestock thus improperly forced into inventory did not involve a change of accounting method and that

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5—As pointed out in the **Ekberg** case, a "meaningful choice" as to accounting methods and as to methods of valuing inventory was not possible until 1944, when it first became apparent, by reason of the issuance of I.T.3666, 1944CB270, that capital gain was available on the sale of raised breeding animals, provided the rancher did not adopt the accrual method of accounting and the unit-livestock-price method of valuing his inventories.

6—Actually, the taxpayers in the **Wardlaw** case selected a constant unit price method of valuing their inventory when they commenced business, but as noted above, Reg. 111, Sec. 29.22(c)-6 required that taxpayers using a constant unit price method prior to 1944 were forced to elect and use the unit-livestock-price method for years after 1944. Obviously, the selection of a constant unit price method was not a meaningful choice, because at the time of the selection (long prior to 1944) capital gains treatment for the sale of breeding stock was not authorized.

hence neither the approval nor the consent of the Commissioner was required to remove the livestock from inventory. (R.17). It was stipulated that the Commissioner, during the years in question, had consistently refused to entertain applications by accrual-method livestock farmers to change to the cash method of accounting until the final regulations under Section 481 of the Internal Revenue Code of 1954 were issued, which was on February 19, 1959. (R.81). See also Pet., Appendix A, Page 21.

The Court of Appeals for the Fifth Circuit, noting that the District Court had followed the opinion in **Scofield v. Lewis,** 251 F.2d 128, (C.C.A. 5th, 1958), and recognizing that such opinion was directly in point and was controlling, affirmed the judgment of the District Court with respect to the raised breeding animals.

REASONS FOR DENYING THE WRIT

(1) There is **no conflict** between the decisions in **Wardlaw** and **Lewis** on the one hand and **Ekberg** on the other hand, as petitioner contends. In 1961, petitioner **opposed** the petition for a writ of certiorari filed with this Court by the taxpayer in the **Ekberg** case on the ground that

> "The decision of the Court of Appeals for the Fifth Circuit in **Scofield v. Lewis** . . . , with which the petitioner asserts a conflict, is . . . distinguishable . . . Further review of the issue by this Court is unnecessary." See **Ekberg,** Brief for the United States in Opposition, p. 4

Now, four years later, petitioner says the decision of the Court of Appeals for the Fifth Circuit in the instant **Wardlaw** case is in "direct conflict" with the decision in **Ekberg.** (Pet. p. 5).[6a] This is equivalent to saying that

6a—**Carter v. Comm.,** 257 F. 2d 595, cited by petitioner, is not in point: It did not involve the same Regulation section now in question, and it did not involve raised breeding animals.

the decision in **Lewis** is in direct conflict with **Ekberg**, because the Government has never questioned the fact that the **Lewis** case and the **Wardlaw** case are identical, and the District Court and Circuit Court of Appeals have so held.

Petitioner's inconsistency is, of course, due to the fact that he won the **Ekberg** case but lost the **Wardlaw** case. However, since this Court denied the petition for a writ in the **Ekberg** case, recognizing that **Lewis** and **Ekberg** were, as the Government contended, "distinguishable", there is no reason to expect this Court to reverse its position now.

Clearly the decisions in **Wardlaw** and **Lewis** are distinguishable from the decision in **Ekberg**. The distinction lies in the very important fact that when the taxpayers in the **Lewis** and **Wardlaw** cases had their chance to choose between the cash method of accounting and the accrual method, and to select a method of valuing their inventories, which chance came when they began business prior to 1944,[7] it was not recognized that a farmer could get capital gain treatment on the sale of his breeding animals under any circumstances, regardless of what method of accounting or what method of valuation he adopted; whereas, when the taxpayer in the **Ekberg** case had his chance to choose his method of accounting and his method of valuation, which chance came when he began business in 1947, it was clearly recognized that a farmer could get capital gain treatment on the sale of his breeding animals, provided he did not adopt the accrual method of accounting and elect the unit-livestock-price method of valuing his inventory.[8] Thus the taxpayer in the **Ekberg**

7—The taxpayer in **Lewis** began business in 1939; in **Wardlaw**, the taxpayers began business in various years from prior to 1913 to 1941. See footnote 1, supra.

8—By reason of I.T. 3666 and Sec. 29.22(c)-6 of Reg. 111, as amended by T.D. 5423, both of which were published in 1944.

case had a "considered and meaningful choice"[9] when he selected his accounting method and his method of valuing his inventory, because at the time he made his selection the consequences of the available options were known. The taxpayers in the **Lewis** and **Wardlaw** cases, on the other hand, did not have a meaningful choice because when they had to make their selection, long prior to 1944, the consequences of the available options were not known; in fact, prior to the issuance of I.T.3666 in 1944 there was no indication that livestock farmers could get capital gain treatment on the sale of their breeding animals regardless of **what** methods of accounting or methods of valuation they might use.

The **Ekberg** case held that the critical date, before which choices of accounting method and valuation method were not meaningful, and after which such choices were meaningful, was 1944, the year in which the Internal Revenue Service issued I.T.3666, which recognized for the first time that, under Section 117(j) of the Internal Revenue Code, capital gain treatment was available on the sale of breeding animals, provided certain requirements were satisfied. In the same year, 1944, the Regulations established the farm price method and the unit-livestock-price method of valuing inventories. If a farmer elected to use the unit-livestock-price method of valuing his inventory, he was required to include his raised breeding animals in inventory.[10] In the **Ekberg** case, the taxpayer elected to use the unit-livestock-price method, and at the time he did so he knew that it required him to include his raised breeding animals in inventory; he was not re-

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9—**United States v. Ekberg.** supra, at page 924.

10—Farmers using the farm-price method of valuing inventories, or the lower of cost or market method, were not required to include their raised breeding animals in inventory.

quired to elect the unit-livestock-price method, but did so knowing its consequences, and the Court in the **Ekberg** case found that his choice was therefore "considered and meaningful" and he was therefore bound by it. In the **Wardlaw** and **Lewis** cases, on the other hand, the taxpayers never had a choice as to whether they would or would not use the unit-livestock-price method of valuation, because the 1944 Regulations provided that farmers who had, for taxable years prior to 1944, adopted a constant unit price method of valuing livestock inventories, and had filed returns on that basis, would be **considered as having elected** the unit-livestock-price method.[11] Since the taxpayers in the **Wardlaw** case had adopted the constant unit price method prior to 1944, and had filed returns on that basis prior to 1944, and the taxpayer in the **Lewis** case had done likewise, they were both **compelled** by the 1944 Regulations to use the unit-livestock-price method and hence **required** to put their raised breeding animals in inventory.

The Government in its brief opposing the petition for a writ in the **Ekberg** case, on the ground that there was no conflict with the **Lewis** case, points out (at p.7) this fundamental distinction between the **Lewis** and **Ekberg** decisions in the following language:

> "In **Scofield v. Lewis,** the Fifth Circuit . . . emphasized its belief that the taxpayer there elected to use the unit-livestock-price method, and thereby subjected his breeding herd to valuation by the same method, before it was known that the gain upon the sale of a breeding herd could be treated as capital gain rather than ordinary income. It should be noted that the taxpayer in **Lewis** had

11—Reg. 111, Sec. 29.22(c)-6, as amended by T.D.5423: "A livestock raiser who has, for taxable years beginning prior to January 1, 1944, adopted a constant unit price method of valuing livestock inventories and filed returns on that basis, will be considered as having elected the 'unit-livestock-price method'."

carried his breeding herd in inventory since 1939. On the other hand, in the instant case, the taxpayer has been engaged in the business of raising Angus cattle only since 1947 . . . , and the Court of Appeals pointed out . . . that, in 1944, the Internal Revenue Service issued I. T. 3666, 1944 Cum. Bull. 270, recognizing that capital gains treatment was available upon the disposition of breeding cattle if all other necessary elements were satisfied. Therefore, the taxpayer here, unlike the taxpayer in the **Lewis** case, did have a meaningful option with respect to his accounting method when he went into business in 1947."

(2) In the **Wardlaw** case, Regulation 1.471-6(g) was held invalid as to the taxpayers there before the Court because they **were not** afforded a meaningful choice at the time they had to select their accounting method, and were afforded no choice at all as to the method they would use in valuing their inventory (being forced to use the unit-livestock-price method). In **Ekberg,** the Regulation in question was held valid as to the taxpayer before the Court, because the taxpayer there **was** afforded a meaningful choice, both as to accounting method and as to valuation method.

Petitioner discusses at some length this Regulation 1.471-6(g), which requires accrual-method farmers using the unit-livestock-price method to include their raised breeding animals in inventory along with animals held for sale to customers in the ordinary course of business. (Pet. pp. 6-15). Throughout the discussion, petitioner emphasizes that the farmer is given a **choice** between the cash method of accounting and the accrual method (Pet. p. 7), and that "the Regulations permit (but do not require)" the farmer to elect the unit-livestock-price method. (Pet.p.8). **However, the petitioner then proceeds to ignore completely the fact that the taxpayers in the Wardlaw case did not have a meaning-**

ful choice when they were required to choose their method of accounting, and had no choice at all as to whether they would use the unit-livestock-price method of valuing inventory.[12] As we have seen, they were **required** to use the unit-livestock-price method because they had previously used a constant unit price method; and when they chose this constant unit price method, long prior to the publication of I.T. 3666 in 1944, it was obviously not a meaningful or knowledgeable choice because they had no way of knowing, prior to 1944, that such choice would eventually force them, because of Sec. 29.22(c)-6, to use the unit-livestock-price method, which would in turn deprive them of full capital gains treatment for their raised breeding animals, a treatment which was completely unknown prior to the issuance of I.T. 3666 in 1944. Under these circumstances, it is submitted that petitioner's discussion of the Regulations has no relevance as far as the taxpayers in the **Wardlaw** case are concerned.[13]

12—For a choice to be meaningful, the person entitled to choose must have knowledge of the consequences of available alternatives. See **Ekberg, supra.** Petitioner admits that this is true. See Appendix B, infra. Petitioner also has admitted that the taxpayer in **Lewis** did **not** have a "meaningful option", and has pointed out that the reason for this was that the taxpayer in **Lewis** began business prior to 1944, which was the first year he could have made a meaningful choice. See quotation, page 9, supra, from Government's brief opposing writ in **Ekberg** case; see also Appendix B, infra. It follows obviously that the taxpayers in the **Wardlaw** case had no meaningful choice, since six of them began business in 1935 or earlier, and one in 1941.

13—It is very important to note here that the petition filed in this case seeks to cover both the **Wardlaw** case and another case, **United States of America, Petitioner** v. **John Catto, Jr. and Roxana Catto.** The petition states that the pertinent facts in both cases are substantially the same (Pet. p. 3.). This is not true. The truth is that there is a vital distinction between the two cases, which were argued at different times and before different panels of the Fifth Circuit Court of Appeals. The vital distinction lies in the fact that in the **Catto** case the Government argued that the taxpayers there had a meaningful choice "in 1948 and 1951, when they embarked on their proprietorships" and selected the accrual method of accounting and the unit-livestock-price method of valuing inventory, and on this ground the Government sought to distinguish **Catto** from **Lewis.** See Appendix B of this Brief. In the **Wardlaw** case, however, the Government did not contend that the taxpayers had a meaningful choice, either

(3) The livestock farmer using the cash method of accounting receives very fair treatment from the Commissioner in the handling of his raised breeding animals: He is permitted to deduct the cost of raising these animals, and when he sells the animals at the end of their useful lives he is permitted to treat the entire proceeds from the sale as capital gain, his basis being zero. This treatment follows normally from Section 117(j), which provided that gain from the sale of "property used in the trade or business . . . which is subject to the allowance for depreciation" should be taxed as capital gain; and from the recognition by I.T. 3666 that breeding animals constituted property used in the trade or business; and from the 1951 amendment to Section 117(j), made retroactive to 1942, which stated explicitly that the term "property used in the trade or business" included "livestock . . . held . . . for . . . breeding . . . purposes . . ."; and from the 44-year old Regulation, now Reg. 1.162-12, permitting farmers to take a current expense deduction for the costs of raising livestock held for breeding purposes.[14]

The Commissioner, however, was not in sympathy with the idea that livestock farmers should be permitted an ordinary deduction for the cost of raising breeding animals, and then get capital gain treatment

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as to accounting method or method of valuing inventory, because it was perfectly obvious that the taxpayers in the **Wardlaw** case, having started business long before the publication of I.T. 3666, had no meaningful choice as to accounting method, and had no choice at all as to whether or not they would use the unit-livestock-price method of valuation.

14—Currently, the right to deduct the cost of feeding and raising livestock is granted by Reg. 1.162-12. The right was granted in 1921 by Reg. 45, Art. 110. In a letter to Senator George from the Secretary of the Treasury in 1952 it was stated that ". . . since the early days of the income tax. the regulations have permitted farmers to take current expense deductions for the cost of raising livestock intended for . . . breeding . . . purposes." See Appendix B of the Government's Brief in the Court of Appeals, at p. 35. **The deduction is granted to all livestock farmers, regardless of whether they are on the cash or accrual method of accounting and regardless of what method of valuation they use.**

when the breeding animals were sold. Consequently, the Commissioner conceived the idea of **compelling** the accrual-method farmer using the unit-livestock-price method of valuing his inventory to include his breeding animals in his inventory along with his animals held for sale to customers in the ordinary course of business, thereby offsetting the raising costs deduction to which the farmer was entitled and, as we shall see, effectively blocking any capital gains treatment when the breeding animals were sold. The accrual method farmer was thus the unwilling victim of what the Court of Appeals in **Ekberg** called "the Commissioner's continuing reluctance to give full application of the statute [Sec. 1231] to breeding stock. . . .". **Ekberg**, p. 923, matter in brackets added.

Briefly, the accrual-method farmer using the unit-livestock-price method of valuation is treated as follows:

(a) The farmer is permitted to deduct the cost of raising his livestock held for breeding purposes. The right to deduct raising costs (i.e., shelter, food, medicine and other normal maintenance costs) has been specifically granted by the Regulations for over 44 years.

(b) The Commissioner offsets the benefit of the expense deduction granted for raising costs by requiring that raised breeding animals must be put in the farmer's inventory, at birth, at an estimated opening value, along with his animals held for sale in the ordinary course of business, and that the amount of the estimated annual increase in the value of the breeding animals should appear as an annual increase in inventory. The estimated annual increase would be equal to, or greater than, the farmer's actual annual raising costs. Adding opening value to inventory, and

increasing inventory by annual increments in value, of course creates ordinary income, and thereby effectively offsets the deduction for raising costs.

(c) This process of granting the expense deduction with one hand and taking it away with the other continues until the animal reaches maturity, at which time the accumulated inventory value for the animal has reached its peak. Generally, the breeding animal is then kept during its useful life as a breeder, and thereafter sold. The sale price (particularly of sheep and goats) rarely exceeds the value at which the animal last appeared in inventory, and frequently is less than inventory value. Consequently, the capital gain treatment prescribed by Congress is defeated, simply by eliminating the element of gain. Instead, by the device of forcing raised breeding animals into inventory, along with animals held for sale in the ordinary course of business, the Commissioner not only has effectively defeated his own 44-year old Regulation expressly granting an ordinary deduction for raising costs, but has converted into ordinary income what would otherwise, if the farmer were on a cash basis, be taxed as capital gain.[15]

It is plain that in the instant case the Regulation requiring that raised breeding animals be put in inventory along with animals held for sale to customers in the ordinary course of business frustrates the will of Congress: (a) Certainly Congress did not intend this gross discrimination against an accrual basis farmer forced to use the unit-livestock-price method, as com-

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15—A raised breeding animal is depreciable, being an asset used in the trade or business but not held for sale to customers in the ordinary course of business; but there is nothing to depreciate, since it cost nothing to acquire the animal at birth, and the raising costs thereafter incurred are merely maintenance costs which are specifically deductible under Reg. 1.162-12, and predecessor Regulations going back to 1921. Petitioner admits that depreciation is not available. (Pet. p. 10, footnote 5.).

pared with the cash method farmer. (b) Certainly Congress did not intend that animals which it had specifically characterized as "property used in the trade or business" should be forced into inventory along with animals held for sale to customers in the ordinary course of business; assets held for sale belong in inventory, whereas property used in the trade or business does not. (c) Certainly Congress did not intend that the 44-year old Regulation expressly giving livestock farmers the right to deduct the costs of raising animals held for breeding purposes should be defeated by a device forcing obviously non-inventory assets into inventory, and thereby creating false ordinary income.[16]

(4) Finally, it is apparent from the foregoing that the point here involved is extremely narrow[17], not of widespread interest or application, and for that reason alone would not appear to warrant review by this Court.

16—If the Commissioner wishes to oppose the deduction of costs of raising breeding animals as an ordinary expense, and insist that such costs be capitalized, then he ought to ask for legislation so holding, and not adopt a dubious Regulation designed to trap the accrual-method farmer, while surrendering completely to the cash-method farmer. Congress, so far, has taken the clear and unmistakable position that farmers should receive capital gain on the disposition of their breeding animals; and, by a Regulation of 44 years standing, the cost of raising breeding animals is a deductible expense, not to be denied by forcing breeding animals into inventory, where, as assets used in the trade or business, they obviously do not belong, or by otherwise seeking to compel a capitalization of such expenses.

17—Since the **Wardlaw** and **Lewis** cases are not in conflict with **Ekberg**, it may well be that the only point of difference in the decisions in any of these cases, including the **Catto** case, is that **Ekberg** used 1944 as the date after which all choices were "meaningful", whereas the **Catto** decision used 1951. The case of **Little v. Commissioner**, 294 F. 2d 61, (C.C.A. 9th, 1961), cited by petitioner as being in accord with **Ekberg** and in conflict with **Lewis**, apparently used 1942. All of the taxpayers in the **Wardlaw** case began business prior to 1942.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari in the **Wardlaw** case should be denied.

Respectfully submitted,

CLAIBORNE B. GREGORY

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September 30, 1965

CERTIFICATE OF SERVICE

It is hereby certified that service of this Brief has been made on opposing counsel by depositing five (5) copies thereof in the United States Mail (Air Mail) with postage prepaid, addressed to THURGOOD MARSHALL, Solicitor General of the United States, Department of Justice, Washington, D.C., 20530, and by depositing one (1) copy thereof in the United States Mail with postage prepaid, properly addressed to ERNEST MORGAN, United States Attorney for the Western District of Texas, Federal Bldg., San Antonio, Texas, on this the 1st day of October 1965.

ELWOOD CLUCK

Attorney for W. H. Wardlaw,
Independent Executor of the Estate
of Crawford W. Wardlaw,
Deceased, et al, Respondents

APPENDIX A

Reg. 111, Sec. 29.22(a)-7. Gross income of farmers. —A farmer reporting on the basis of receipts and disbursements (in which no inventory to determine profits is used) shall include in his gross income for the taxable year (1) the amount of cash or the value of merchandise or other property received during the taxable year from the sale of livestock and produce which were raised during the taxable year or prior years, (2) the profits from the sale of any live stock or other items which were purchased, and (3) gross income from all other sources. The profit from the sale of live stock or other items which were purchased after February 28, 1913, is to be ascertained by deducting the cost from the sales price in the year in which the sale occurs, except that in the case of the sale of animals purchased as draft or work animals or solely for breeding or dairy purposes and not for resale, the profit shall be the amount of any excess of the sales price over the amount representing the difference between the cost and the depreciation theretofore allowed (but not less than the amount allowable) in respect of such property as a deduction in computing net income.

In the case of a farmer reporting on the accrual basis (in which an inventory is used to determine profits), his gross profits are ascertained by adding to the inventory value of live stock and products on hand at the end of the year the amount received from the sale of live stock and products, and miscellaneous receipts for hire of teams, machinery, and the like, during the year, and deducting from this sum the inventory value of live stock and products on hand at the beginning of the year and the cost of live stock and products purchased during the year. In such cases all live stock

raised or purchased for sale shall be included in the inventory at their proper valuation determined in accordance with the method authorized and adopted for the purpose. Also live stock acquired, for draft, breeding, or dairy purposes and not for sale, may be included in the inventory, instead of being treated as capital assets subject to depreciation, provided such practice is followed consistently by the taxpayer. In case of the sale of any live stock included in an inventory their cost must not be taken as an additional deduction in the return of income, as such deduction will be reflected in the inventory. (See section 29.22(c)-6.

Reg. 111, Sec. 29.22(c)-6 (As amended by T. D. 5423, Dec. 15, 1944). Inventories of livestock raisers and other farmers. * * *

Because of the difficulty of ascertaining actual cost of livestock and other farm products, farmers who render their returns upon an inventory basis may value their inventories according to the "farm-price method", and farmers raising livestock may value their inventories of animals according to either the "farm-price method" or the "unit-livestock-price method".

The "farm-price method" provides for the valuation of inventories at market price less direct cost of disposition. If this method of valuing inventories is used, it must be applied to the entire inventory except as to livestock inventoried, at the taxpayer's election, under the "unit-livestock-price method". If the use of the "farm-price method" of valuing inventories for any taxable year involves a change in method of valuing inventories from that employed in prior years, permission for such change shall first be secured from the Commissioner as provided in section 29.41-2.

The "unit-livestock-price method" provides for the valuation of the different classes of animals in the inventory at a standard unit price for each animal within a class. A livestock raiser electing this method of valuating his animals must adopt a reasonable classification of the animals in his inventory with respect to the age and kind included so that the unit prices assigned to the several classes will reasonably account for the normal costs incurred in producing the animals within such classes. Thus, if a cattle raiser determines that it costs approximately $15 to produce a calf, and $7.50 each year to raise the calf to maturity, his classifications and unit prices would be as follows: calves, $15; yearlings, $22.50; two-year old, $30; mature animals, $37.50. The classification selected by the livestock raiser, and the unit prices assigned to the several classes, are subject to approval by the Commissioner upon examination of the taxpayer's return.

A taxpayer who elects to use the "unit-livestock-price method" must apply it to all livestock raised, whether for sale or for breeding, draft, or dairy purposes. Once established, the unit prices and classifications selected by the taxpayer must be consistently applied in all subsequent years in the valuation of livestock inventories. No changes in the classification of animals or unit prices will be made without the approval of the Commissioner.

A livestock raiser who uses the "unit-livestock-price method" must include in his inventory at cost any livestock purchased, except that animals purchased for breeding, dairy, or draft purposes can, at the election of the livestock raiser, be included in inventory or be treated as capital assets subject to depreciation after maturity. If the animals purchased are not mature at the time of purchase, the cost should be increased

at the end of each accounting year in accordance with the established unit prices, except that no increase is to be made in the year of purchase if the animal is acquired during the last six months of that year. If the records maintained permit identification of a purchased animal, the cost of such animal will be eliminated from the closing inventory in the event of its sale or loss. Otherwise, the first-in first-out method of valuing inventories must be applied.

If a taxpayer using the "farm-price method" desires to adopt the "unit-livestock-price method" in valuing his inventories of livestock, permission for the change shall first be secured from the Commissioner as provided in section 29.41-2. However, a taxpayer who has filed returns on the basis of inventories at cost, or cost or market whichever is lower, may adopt the "unit-livestock-price method" for valuing his inventories of livestock for taxable years beginning after December 31, 1943 without formal application for permission, but the classifications and unit prices selected are subject to approval by the Commissioner upon examination of the taxpayer's return. A livestock raiser who has, for taxable years beginning prior to January 1, 1944, adopted a constant unit price method of valuing livestock inventories and filed returns on that basis will be considered as having elected the "unit-livestock-price method".

* * *

APPENDIX B

The Government described the nature of a "meaningful choice" as to methods of accounting, and pointed out why the taxpayers in the **Catto** case had a meaningful choice, as follows (page 14, footnote 5, Brief for the Appellant, in the Court of Appeals below):

> "A choice between using the accrual and cash methods of reporting became 'meaningful' as early as 1942, certainly by 1944, when it became clear that breeding cattle could be given capital gain treatment and that cash basis taxpayers were permitted to expense their raising costs against ordinary income. See I.T.3666, 1944 Cum.Bull.270, 271-272. Thus, any taxpayer who chose the accrual method of accounting after 1942 (or 1944) presumably knew that he was being denied this special advantage accorded cash-basis taxpayers.
>
> "The taxpayers here selected the accrual method in 1948 and 1951, when they embarked on their proprietorships. Thus their choice was meaningful, contrary to the lower court's finding (R.48) that 'Plaintiffs did not have a knowledgeable choice as to accounting methods when they began operating their ranch as sole proprietorships in [1948 and 1951] ***.'"

The Government then stated that the selection of the unit-livestock-price method of valuing inventory, by the taxpayers in the **Catto** case, was meaningful, and that on this ground **Catto** could be distinguished from **Lewis** (page 18, including footnote 9, Brief for the Appellant, in the Court of Appeals):

> ". . . the taxpayers here [are] bound by their election to [inventory their breeding cattle] since they knowingly . . . elected to inventory their breeders

when they chose the unit-livestock-price method of inventorying their cattle."[9] (Matter in brackets added).

* * *

"9—The meaningfulness of their election can be said to distinguish this case from **Scofield v. Lewis, supra.** As noted above, in **Lewis** the taxpayer bound himself to the accrual system, using the unit-livestock-price inventory method **before** breeding animals began to receive capital gains treatment."